Family Child Care Recordkeeping and Taxes

Presented by Tom Copeland
for the Office of Child Care's National Center on Early Childhood Quality Assurance

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Learning Objectives

After completing this course, you will be able to:

- Keep accurate business records.
- Track your business income.
- Deduct your business expenses.
- Calculate your time-space percentage.
- Depreciate your home and home improvements.
- Follow special rules for claiming vehicle and food expenses.

Meet Your Instructor – Tom Copeland

Tom Copeland is a lawyer and has been the nation's leading trainer, author, and advocate on business issues for family child care providers since 1981.

Tom is happy to answer your questions about this course at no charge. Your question might be addressed on Tom's website, www.tomcopelandblog.com, or you can email him at tomcopeland@live.com.

Beginning and Pretest

What Type of Provider Are You?

Welcome!

This class is for family child care providers. You may be providing child care in your home or in another building outside your home. You may be licensed, regulated, certified, or have some other designation.

Each state, territory, or tribe has its own rules about how family child care providers are regulated. You may be called a family child care home, a group family, or an exempt provider. An exempt provider is legally operating their business but does not care for enough children to be regulated.

Whatever you may be called, this class is for you.

What Is the Tax Consequence of Your Status?

Whether you are licensed exempt, a family child care home, or a group home, the tax rules are the same!

- You must report all the money you earn as income.
- You can deduct all the same expenses, including expenses associated with your home.

Everything covered in this class applies to you!

If You Are Operating Illegally

If you are not in compliance with your state, territory, or tribe’s child care regulation rules, you are operating illegally.

- In this case, you must report your income. You can claim all business expenses except for expenses associated with your home.*
- I strongly recommend that you operate legally when caring for children. There are fines and greater liability risks for operating illegally. There are also many benefits for becoming regulated.

*Home expenses include property tax, mortgage interest, rent, utilities, home insurance, house repairs, and house depreciation.

Pretest

- Let’s start off with a Recordkeeping Pretest/Posttest!
- Don’t worry, there will be no grading.
- Do your best to answer these questions now, and you’ll have another chance to answer the same questions at the end of the class.
- If you don’t know the answer, you can guess or choose “I don’t know.”
- Give it a go!

Recordkeeping: Pretest

(1) For every $10 of business expenses you deduct on your tax return, you will save about $3–$4 in taxes.

a. True

b. False

c. I don't know

(2) You must save your business records for at least 7 years after filing your taxes.

a. True

b. False

c. I don't know

Recordkeeping: Pretest

(3) You can deduct a portion of the cost of a washer and dryer used in your business.

a. True

b. False

c. I don’t know

(4) You will lose money if you join the Child and Adult Care Food Program (“Food Program”), because you won’t be able to deduct all your food expenses.

a. True

b. False

c. I don’t know

Recordkeeping: Pretest

(5) You should not depreciate your home if you are planning to sell it soon.

a. True

b. False

c. I don’t know

(6) You must depreciate a new carpet over 15 years.

a. True

b. False

c. I don’t know

Recordkeeping: Pretest

(7) You can count time you spend on recordkeeping after children have left for the day in your time-space percentage calculation.

a. True

b. False

c. I don't know

(8) If you went into business 10 years ago and did not depreciate your appliances, it's too late to deduct them on your taxes.

a. True

b. False

c. I don't know

Recordkeeping: Pretest

(9) You can always deduct the business portion of your car loan interest when claiming car expenses.

a. True

b. False

c. I don't know

(10) You must report as income any parent fees, such as registration fees and late pick-up fees.

a. True

b. False

c. I don't know

Thanks for taking this quiz. Now let's move on.

Section 1
Keep Accurate Business Records

Do You Love Recordkeeping?

- Most family child care providers do not.
- You would probably rather care for children than spend time keeping records!
- But taking care of children is only half of your job. The other half is taking care of business.

Good Recordkeeping Makes Sense

- The more carefully you keep your records, the more expenses you can deduct.
- The more business expenses you deduct, the less taxes you will pay.
- In fact, you will probably earn more money per hour keeping records than you will earn per hour caring for children!
- Good recordkeeping equals more money in your pocket.

This course is about how you can save money by lowering your taxes.

Did You Know?

- Your business income minus your business expenses equals your business profit.
- You will owe about 30%–40% in taxes on your business profit.
    - This includes 15.3% Social Security/Medicare tax, 10%–22% federal income tax, and state income taxes (if any).
- That’s the bad news …

The Good News

- For every $10 of a business deduction you claim on your tax return, you will save about $3–$4 in taxes!
- Therefore, it’s worth your while to save receipts for every business expense.
- Keeping business records is not fun, but the rewards are great!
- The following are some tips to help make recordkeeping easier.

“Adequate Records”

IRS rules require that you keep “adequate records” to claim business expenses. The best type of record you can have is a receipt, but that is not the only record that can support your business deductions. Here is a list of adequate records:

- Receipt.
- Cancelled check – Describe what you bought in the memo line of the check.
- Credit or debit card statement – Describe what you bought on the monthly statement.
- Written record – This is a note created by you that details what you purchased if you didn’t get a receipt (for example, from a garage sale) or if you lost your receipt.
- Photograph – If you bought something so far this year and have no record of it, take a picture and make a note of when you bought it and how much it cost.

Don’t Give Up!

- A receipt is the best adequate record you can have when claiming a business expense.
- But you can still claim an expense without a receipt.
- If you lost a receipt or never got one (garage sale, Craigslist, etc.), do your best to reconstruct the expense. Write out: “Garage sale, used highchair, $35, paid cash, 1400 Smith Avenue, 3/18/202_.”
- You can reconstruct records showing you had an expense, even without a receipt.
- Going forward, try your best to save receipts!

Mark Your Receipts

On your receipts, indicate in writing items that are 100% business ("B") or shared ("S").

* 100% business items are those used only for your business (children's furniture, toys, diapers, etc.).

* Shared items are used for both business and personal purposes (cleaning supplies, furniture, household tools, lawn mower, etc.).

Do not mark an item as 100% business unless it is never used for personal purposes. If your own children use it only during daycare hours, it's still 100% business.

No need to mark expenses that are 100% personal.

Exercise #1 Marking Expenses

A receipt has the following expenses on it. Identify each expense as either 100% business (“B”) or shared (“S”).

Laundry detergent

Light bulbs for kitchen

Child’s cot

Garden hose

Cubbies

Refrigerator

Exercise #1 Answers

Laundry detergent – Shared

Light bulbs for kitchen – Shared

Child’s cot – 100% business

Garden hose – Shared

Cubbies – 100% business

Refrigerator – Shared

File Receipts Away

- Once you have marked your receipt, put it in a folder with similar expenses (toys, supplies, utilities, cleaning supplies, etc.).
- If a receipt has more than one type of expense on it (for example, a toy and a supply item), it doesn't matter in which folder you place it.
- All expenses will eventually get added together on your tax return, so don't spend time separating out expenses from one receipt.

Save All Receipts!

- Save receipts for all your business and personal expenses!
- Almost everything you buy that is associated with your home is at least partly deductible in your business.
- It doesn't matter why you bought something; instead, how that item is used determines whether it is deductible or not in your business.
- It is easier to get into the habit of saving all receipts rather than thinking about whether something is deductible or not when you buy it.

Monthly Review

It will be easier to claim all your business expenses if you conduct a monthly review rather than wait until the end of the year. At the end of each month, ask yourself if you have saved:

- A record of all business income.
- A receipt for each of your business expenses. If not, create a written record and take a picture of the item.
- A record of:
  - Every business trip you took.
  - Every meal and snack you served.
  - All the hours you worked.

If you didn't keep track of these records, reconstruct them at the end of each month.

What if a Record Fades?

- Business records must be saved for at least 3 years after filing your tax return. (Payroll records must be saved for at least 4 years.) Some states may require you to save records longer.
- If a record fades before then, you may be in trouble if you are audited.
- Therefore, either make a photocopy of your receipts or scan them into a computer.
- Download the scanned receipts onto a flash drive and put it in your safe deposit box.

Store Records

- Even if you scan your receipts, save paper copies of all your business records.
- Store them in a safe place, such as a file cabinet or plastic storage bin.
- After 3 or 4 years, you can start throwing away your old business records. However, save copies of your tax returns forever.

Recordkeeping Tools

I've just told you about all the records you should keep—and it's a lot of information! Here are some tools you can use to help you organize them.

- Redleaf Calendar Keeper
  - Desk calendar with monthly expense charts, attendance and payment logs, mileage records, and meal and snack tracking chart. Monthly expense chart identifies expenses as seen on tax forms. Also includes monthly nutritious recipes and activities. Learn more at www.redleafpress.org or call 1-800-423-8309.
- KidKare Online Software Program
  - Ability to file Food Program claims electronically with your Child and Adult Care Food Program (CACFP) sponsor. Tracks all income and expenses, business miles, parent invoices, and hours worked. Also contains a series of reports that simplifies data transfer to the tax return. Can purchase an app to electronically transfer bank payments with parents. Includes 30-day free trial. Learn more at www.kidkare.com.

Recordkeeping Tools (cont.)

- Quickbooks
  - Online accounting software lets you set up your own income and expense categories. It is not family child care-specific. Learn more at www.quickbooks.com.
- Excel spreadsheet or your own system
  - You can always use an Excel spreadsheet, write things down on paper, or create your own system to keep track of your income and expenses.

End-of-Year Parent Receipts

- At the end of the year, parents will want a receipt from you indicating how much they paid for child care.
- Parents will also want an identification number from you so they can claim the federal child care tax credit.
- You are not required to give them this information! But it’s a good idea and a sign of professionalism for you to do so.
- You can write out your own receipt for each parent or use IRS Form W-10.

Employer Identification Number (EIN)

- When giving parents your identification number, do not give out your Social Security number. Instead, get an EIN to avoid identity theft.
- Go to www.irs.gov (search for "online EIN") or call the IRS at 1-800-829-4933.
- It's free!

Section 1 Quiz

(1) You can only deduct a business expense if you have a receipt.

True ___ False ___

(2) You will owe about 30%–40% taxes on your business profit.

True ___ False ___

(3) You must save your business receipts for 7 years.

True ___ False ___

Section 1 Quiz Answers

(1) False

(2) True

(3) False

Section 2
Track Your Business Income

Track Your Income

Recordkeeping can be divided into two tasks: (1) tracking income and (2) tracking expenses.

Any money you receive as part of running your business is taxable income and must be reported on your tax return. This includes:

- Parent fees (including late fees, registration fees, co-payments, etc.)
- Food Program reimbursements (Exception: any reimbursements received for your own children)
- Payments from a parent subsidy program
- Grants

Parent Payments

- Money received from parents is taxable income.
    - Regardless of how little the amount
    - Even if the parent doesn’t claim the federal child care tax credit

- If you barter with a parent for services, you must treat the transaction as if money changed hands.
    - For example, let’s say a parent paints your house, and you give her 1 month of free child care. If the value of 1 month of child care is $750, you must report $750 as income, even if you didn’t receive the money.

Grants

- Federal, state, and local grants are taxable income.
- You can deduct the business items for which you use the grants.
  - $1,000 grant used exclusively for business = $1,000 deduction.
  - $1,000 grant used for business and personal purposes x 30% time-space percent (for example) = $300 deduction.
- You are always financially better off receiving a grant!

Reporting Income

- Report income in the year you receive it, not the year you earned it.
- A check received in December but not deposited until January is December income.
- Gifts from parents are not income, but a bonus is income.
  - Birthday and Christmas presents are not income.
  - “Thanks for your work this year” is a bonus and is income.

Two Key Rules for Tracking Income

The IRS is looking for unreported income when they conduct audits. To help separate out your business income from your personal money, apply the following rules:

(1) Identify the source of all deposits into your business and personal bank accounts. Make a note where the money came from on your deposit slips, check register, or computer software (Food Program check, parent payment, transfer from savings, husband's paycheck, etc.).

(2) Get a signed receipt from each parent at the end of year: "For child care services for the care of Maureen Jones in 202_, paid $4,000. Signed, Mrs. Jones."

This will protect you from parents who claim they paid you more money than you received.

Section 2 Quiz

(1) A grant you receive for your business is taxable income.

True ___ False ___

(2) Income is reportable in the year that you earn it.

True ___ False ___

(3) Bartering with a parent is a way to avoid paying taxes on some income.

True ___ False ___

Section 2 Quiz Answers

(1) True

(2) False

(3) False

Section 3
Deduct Your Business Expenses

Three-Step Process

To deduct your business expenses, you will need to follow this three-step process. Ask yourself:

(1) Is it deductible?

(2) How much is deductible?

(3) When can I deduct it?

Is It Deductible?

An expense is deductible if it's "ordinary and necessary" for your business. Ordinary and necessary is defined as something that is "typical," "useful," "helpful," "common," or "appropriate" for your business.

You are in the business of providing a home learning environment for children. Parents expect you to maintain your home as a home.

Therefore, everything needed to clean, maintain, or repair your home meets the definition of "ordinary and necessary."

What Is Ordinary and Necessary?

- House expenses: Property tax, mortgage interest, utilities, home insurance, house repairs, house depreciation.
- Kitchen: Pots and pans, appliances, dishwasher detergent, plates, etc.
- Playroom: Toys, rug, DVD player, furniture, books, etc.
- Outdoors: Snow blower, rake, fence, new house siding, play equipment, etc.
- Living room: Rug, chair, lamp, ceiling fan, piano, etc.
- Bathroom: Washcloth, soap, toilet paper, rug, bathroom scale, etc.
- Garage and basement: Tools, freezer, garbage can, bicycles, ladder, etc.

Save your receipts for everything associated with your home!

What Are Gifts?

- You can deduct up to $25 per parent per year as a business gift.
- What about gifts you give to the children in your care?
    - If you give a child something only the child uses, that gift is subject to the $25 rule.
        - Examples: Gift card, clothing, a present that is only used by the child.
- If you give a gift to a child who opens it in your home and allows the other children to play with it, this is an activity, not a gift, and is not subject to the $25 rule.

Don’t Spend Money to Get a Deduction!

- It’s wonderful to be able to deduct so many things in your business.
- However, it doesn’t make financial sense to buy something just to get a business deduction.
- If you spend $100 on a toy, your taxes will go down by maybe $30–$40—not $100.
- It doesn’t make sense to spend $100 to save up to $40 in taxes!
- If you need to buy something for your business, go ahead. But financially, it’s better not to spend the money.

What's Not Deductible

- Your clothing (unless it has a business logo or message on it).
- Expenses associated with dogs or cats (the IRS considers them too personal to be deductible).
- The first telephone line into your home (you can deduct the business portion of a second or third phone line).
- Charitable contributions.

Exercise #2 What's Deductible?

Here is a list of expenses. Determine which ones are deductible and which are not.

	Deductible	Not Deductible
Washer and dryer		
Swing set		
Dog food		
Television		
Deck repair		
Shoes only worn for business		
Bed children sleep on		

Exercise #2 Answers

Washer and dryer – Deductible

Swing set – Deductible

Dog food – Not deductible

Television – Deductible

Deck repair – Deductible

Shoes only worn for business – Not deductible

Bed children sleep on – Deductible

Section 3 Quiz

(1) You can deduct the business portion of your refrigerator.

True ___ False ___

(2) You can deduct no more than a $25 gift to a parent or child.

True ___ False ___

(3) It's always better to spend money to get a business deduction.

True ___ False ___

Section 3 Quiz Answers

(1) True

(2) True

(3) False

Section 4
Calculate Your Time-Space Percentage

How Much Is Deductible?

Exclusively personal: If an item is used exclusively for personal purposes, you cannot deduct any of the cost for your business.

- Hairspray, your clothing, your hobbies, etc.

Exclusively business: If an item is used exclusively for your business, you can deduct 100% of the cost.

- Children's activity supplies, food for the children, toys, etc.

Both business and personal: If an item is used for both business and personal purposes, you can deduct part of the cost for your business, using your time-space percentage.

- Freezer, garbage bags, towels, curtains, house paint, etc.

The Time-Space Percentage

The time-space percentage is the most important number that will help reduce your taxes!

The time-space percentage is a formula that you will use to determine how much of your shared expenses (those used for both business and personal use) can be deducted in your business.

Your time-space percentage will be applied to thousands of dollars of shared house expenses. These include:

- Property tax
- Mortgage interest
- House rent
- Utilities (gas, electricity, water, sewer, garbage, cable television, etc.)
- Home insurance
- House repairs
- House depreciation
- Household items (furniture, appliances, pots and pans, lawn mower, decorations, and more!)

The Time-Space Percentage Calculation

To calculate your time-space percentage, you will first calculate a time percent and then a space percent.

Time percent

- How many hours are you using your home for your business?

Space percent

- How many square feet are you using in your home for business on a regular basis?

Time Percent

Your time percent is based on the number of hours when:

- Children are present in your home
- Children are not present in your home, but you are still doing work for your business

Tracking Hours When Children Are Present in Your Home

- Track time from the moment the first child arrives in your home to the moment when the last child leaves.
- Example: You care for children 6:00 a.m. – 5:00 p.m. = 11 hours a day x 5 days per week x 52 weeks per year = 2,860 hours per year
- Keep daily attendance records.
- You do not need to track every minute.
- A sign-in/sign-out sheet is not required by the IRS, but it is a helpful tool for you.

Additional Pick-Up Time

- Let's say your parent pick-up time is 6:00 p.m.
- One parent is regularly late and does not leave your home until 6:30 p.m.
- You want to record when the parent walks out, not when they sign out.
- An extra half-hour per day x 5 days per week = 1.5% of the year!
    - This may seem a small amount, but it isn't!
    - If your house expenses total $20,000 (property tax, mortgage interest, utilities, home insurance, etc.) x an extra 1.5% = $300 additional business deduction.

Tracking Hours When Children Are Not Present in Your Home

- The most important thing you can do to reduce your taxes is to track the hours you work in your home when children are not present!
- Such hours can include time spent cleaning, preparing activities, preparing meals, conducting parent interviews and calls, recordkeeping, researching on the internet, etc.
  - This means you can count the time you spend taking this class, if you are in your home when children are not present!
- Carefully track these hours for at least 2 months each year and use this as an average for the rest of the year.

Example

- Let’s say you worked 40 hours in March and 46 hours in October = 86 hours, divided by 2 = an average of 43 hours.
- Assuming you worked similar hours for the other 10 months of the year: 43 hours x 12 months = 516 additional hours in a year. There are 8,760 hours in a year. 516 hours divided by 8,760 hours = 6% of the year
- A 6% increase in your time percent is a lot! 6% x $20,000 of house expenses = $1,200 additional business deductions.
- There is no upper limit on how many hours you can claim. Don’t hesitate to claim all the hours you are working!

Exercise #3 What Is Your Time Percent?

Based on these facts, what is your time percent?

- The total number of hours in a year is 8,760.
- You cared for children 2,000 hours in a year.
- You spent 500 hours on business activities when children were not present in your home.
- You spent 300 hours cleaning your home when children were present in your home.

Exercise #3 Answers

2,000 hours + 500 hours = 2,500 business hours

2,500 business hours, divided by 8,760 hours in a year = 28.5% time percent

More Rules on the Time Percent

- Don’t count time twice. For example, if you are cleaning while children are sleeping, you can’t count the cleaning time.
- You don’t have to do the work to count the time. If your spouse spends time cleaning up after the children have left while you rest, you can count this time.
- Don’t count time away from your home. You can’t count time spent at training workshops or on shopping trips, even if the purpose of these activities is business.
- Don’t count time spent on normal household chores. Only count hours spent on activities that you wouldn’t do if you weren’t in business. Therefore, for example, count time spent cleaning the home before and after the children arrive, but not time spent mowing the lawn.

Space Percent

Now let's look at your space percent.

When calculating your space percent, look at each room in your home and ask yourself if you use it regularly for your business. "Regular use" means at least two or three times per week.

You can count rooms as regular use in your business even if children are not present in the rooms (laundry room, office, storage room, etc.).

Garage and Basement

Count your garage and basement as part of the total square footage of your home.

You can count them as regular use in your business even if your licensor says children are not permitted in the areas.

- Regular use of a garage – lawn mower, garden hose, outdoor toys, garbage can, car.
- Regular use of a basement – furnace area, laundry room, work bench, storage.

Many providers use close to 100% of the space in their home on a regular basis for their business.

The Time-Space Percentage Calculation

The more hours you work in your home and the more rooms you use on a regular basis in your business, the higher your time-space percentage will be and the lower your taxes!

Example:

11 hours per day caring for children x 5 days per week x 50 weeks per year = 32% of the year

14 hours per week on other business activities x 50 weeks per year = 8% of the year

Total time percent = 40%

If you use 90% of the rooms in your home on a regular basis for your business, your space percent is 90%.

40% time percent x 90% space percent = 36% time-space percentage

A typical family child care provider has a time-space percentage between 35% and 45%.

The Exclusive-Use Room Rule

This is a special rule that allows providers to claim a higher time-space percentage if they use one or more rooms in their home exclusively for their business.

To claim this special rule, you must never, ever use it for personal purposes, even once a year! Your own children can use this room during daycare hours but cannot use it after the daycare children are gone.

Rooms that are exclusively used for your business might include a downstairs playroom, storage room, or crib room.

Exclusive-Use Room Rule Example

Let's assume a provider has a 2,000-square-foot home, and one room (200 square feet) is used exclusively for her business. Let's also assume that the rest of her home is used regularly for her business and her time percent is 40%.

To calculate her time-space percentage, she will add the time-space percentages of her exclusive use room and the rest of the home together.

The time-space percentage of her exclusive use room is 10%: 200 square feet divided by 2,000 square feet = 10%.

The time-space percentage of the rest of her home is 36%: 1,800 square feet divided by 2,000 square feet = 90% space. 90% space x 40% time = 36%.

Final time-space percentage is 46%: 10% exclusive use room + 36% rest of home.

Note: If the exclusive use room was used regularly instead of exclusively, the time-space percentage would be 40% (100% space x 40% time), a loss of 6%!

The Actual Business Use Rule

- If you use an item for your business much more than your time-space percentage, you may want to use the "actual business use" rule.
- Calculate the actual business use of the item by tracking the business and personal use over a month or two.
  - For example, a $3,000 patio used 50% for your business (versus a 27% time-space percentage) = $1,500 deduction versus a $810 deduction.
- Only use an actual business use if it is much higher than your time-space percentage, and the cost of the item is worth at least $1,000. Otherwise, it's not worth doing.

Section 4 Quiz

(1) A bedroom used 20 minutes per day for naps by daycare children can be counted in your space percent.

True ___ False ___

(2) Time spent taking this class can be counted in your time percent only if the children are in your home while you take the class.

True ___ False ___

(3) If you use all the rooms in your home regularly for your business, you can deduct 100% of your house expenses on your tax return.

True ___ False ___

Section 4 Quiz Answers

(1) True

(2) False

(3) False

Section 5
Depreciate Your Home and Home Improvements

When Can I Deduct My Expenses?

- In most instances, you can deduct the business portion of expenses in one year, regardless of the cost
- Certain exceptions must be depreciated. Depreciation means you would deduct a portion of the expense over a number of years. These exceptions are:
  - The home
  - A home addition (garage or adding a new bedroom or other expansion of the home)
  - Certain home improvements
- The rules regarding the number of years you must depreciate these exceptions can change from year to year. Check with a tax professional to learn the latest rules.

Home Depreciation

All family child care providers should depreciate their home. Always!

Depreciating your home will generate a big tax deduction for your business.

$100,000 purchase price of home (minus the value of the land) x 40% time-space percentage = $40,000. Homes are depreciated over 39 years; therefore, $40,000 divided by 39 years = $1,025 business deduction each year. Don’t lose out on this significant tax benefit!

If you rent your home, multiply your rent by your time-space percentage, and deduct this amount.

Sale of Home

- When you sell your home, you will owe tax on the depreciation you have claimed over the years.
- This tax will be owed even if you don’t depreciate your home!
- Therefore, it is terrible advice if someone tells you not to depreciate your home, since you would be giving up big deductions without reducing your taxes later.

Home Improvement Versus Repair

- A home improvement must be depreciated. A repair can be deducted in one year, regardless of the cost.
- Home improvement
  - Making a structural change in your home by moving load bearing walls
  - Replacement of more than half the windows or doors
  - Replacement of more than half of tile or wood floors
- Repairs
  - Painting, wallpapering, fixing broken glass, plumbing/electrical work
  - Replacement of less than 50% of windows or doors
  - Replacement of less than 50% of tile or wood floors

Exercise #4 When Can I Deduct It?

For each expense, indicate when you can deduct it: 1 year or depreciate it.

	Deduct in 1 Year	Depreciate
New carpet		
New furnace		
$2,000 refrigerator		
Replace 6 of 10 windows		
Build new garage		
New deck		

Exercise #4 Answers

New carpet– Deduct in 1 year

New furnace (time-space percent is 30%) – Deduct in 1 year

$2,000 refrigerator – Deduct in 1 year

Replace 6 of 10 windows – Depreciate

Build new garage – Depreciate

New deck– Depreciate

When Does Your Business Begin?

- You can start claiming expenses for your business when your business begins.
- When does your business begin? It begins when you are ready to care for children and are telling others that you are ready.
- Let’s say you start caring for children in February, apply for your license in March, and receive your license in May. Your business began in February, and you can start claiming expenses as of then.
- What if you buy something before your business begins?

Start-Up Rule

You are entitled to deduct items that you use in the business that you owned before your business began. This includes household furniture, appliances, lawn mower, snow blower, bedding, pots and pans, etc.

I recommend that you take an inventory of everything you owned at the time your business began. List everything in your home and its estimated value at the time your business began. Take pictures of all the rooms in your home.

The tax benefit of this business inventory can be substantial. You can deduct up to $5,000 of such items in your first year. You may have to deduct the remaining amount over several years.

What if I Didn’t Depreciate an Item?

- If you did not deduct items that you owned before your business began, or you did not depreciate your home, home improvement, or home addition in previous years, what can you do now?
- You can file IRS Form 3115 and recapture all previously unclaimed depreciation on your current tax return.
- If you were entitled to claim $1,000 each year for home depreciation but didn’t claim it for 10 years: $1,000 x 10 years = $10,000. You can deduct $10,000 on your current tax return using IRS Form 3115.

Section 5 Quiz

(1) You can deduct the business portion of the cost of a new carpet in 1 year.

True ___ False ___

(2) You are always better off financially if you depreciate your home.

True ___ False ___

(3) You cannot deduct the value of furniture and appliances you owned before you went into business.

True ___ False ___

Section 5 Quiz Answers

(1) True

(2) True

(3) False

Section 6
Special Rules for Claiming Vehicle and Food Expenses

Special Rules

- You must follow special rules when claiming expenses for your vehicle and the food you serve.
- Learning how to take the maximum benefit from these two expenses will save you a lot of money on your taxes.

Vehicle Expenses

You want to claim expenses for your vehicle properly, because it can represent a large business deduction.

You can claim a trip in your vehicle as a business expense if the primary purpose of the trip was business.

“Primary purpose” means that more than half of the reason for the trip was business-related.

This can include trips transporting children to the park, school, etc.

This can also include trips to the bank to deposit parent checks, trips to garage sales, trips to training classes, etc.

Pop Quiz

A provider goes to a grocery store and buys business food and personal food. Can she deduct the mileage for this trip?

Yes ___

No ___

I don’t know ___

Pop Quiz Answer

- The correct answer is “I don’t know,” because you don’t know the primary purpose for this trip. If the provider spent more money on business food than personal food, she could count it as a business trip. If the provider spent more time shopping for the business food, she could also count it.
- Many providers always spend more money on business food than personal food for each trip to the grocery store. If that’s true for you, do not try to claim 100% of all trips to the grocery store as business trips. If you spend 80% of the money on business food, count 80% of the trips.

Tracking Vehicle Trips

You need to keep adequate records of all business trips.

- Adequate records include receipts, mileage logs, cancelled checks, debit or credit cards, written records, calendar notations, or photographs.

- You do not need to keep odometer readings, but you should keep a record of the odometer reading at the beginning and end of each year to determine how many total miles each car was driven.
- You can use apps such as MileIQ (www.mileiq.com) to track your trips.

Claiming Vehicle Expenses

There are two ways to claim vehicle expenses:

(1) Use the standard mileage rate.

The 2022 standard mileage rate is $0.58 per mile for business trips. (This changes every year.)

You can also deduct parking and the business portion of your vehicle loan interest.

(2) Use the actual vehicle expenses method.

Claim the business portion of all your vehicle expenses: gas, oil, repairs, car insurance, parking, depreciation on the car, car loan interest, ice scraper, jumper cables, etc.

Your business portion is determined by dividing your business miles by the total miles your vehicle was driven. If you drove 2,000 business miles and 10,000 total miles, your business portion is 20%.

The Child and Adult Care Food Program

The Child and Adult Care Food Program ("Food Program") is a federal program that reimburses you for serving nutritious food. All licensed providers (family child care and large child care homes) are eligible to participate in this program.

There are two reimbursement rates (Tier I and Tier II) that you can receive from the Food Program. You can receive the higher reimbursement rate (Tier I) if you live in a low-income area, serve low-income children, or your family is low income. If you do not meet this test, you will receive the Tier II rate.

Join the Food Program!

You are always financially better off if you participate in the Food Program. You will receive approximately $600 (Tier II) or $1,250 (Tier I) per child per day by participating in the Food Program (2022 rates). The rates for Hawaii and Alaska are higher.

Do you want to win the lottery? If your spouse got a raise, would your family accept it? If parents wanted to pay you more money, would you take it?

The answer is YES! In each of these situations, you will pay more in taxes. But after paying these taxes out of your extra income, you will still have more money left over than before. The same thing will happen if you join the Food Program.

Taxable Income

Reimbursements from the Food Program are taxable income to you. There is an exception: If your own family is low income, you may be eligible to receive reimbursements for your own children. If so, money received for your own children is not taxable income.

You must keep monthly records of the meals and snacks that you serve to the children in your care. This can take some time. However, you will be paid well for this work. If you care for four children and spend three hours per week on paperwork, you would be earning either $15 per hour (Tier II) or $30 per hour (Tier I).

Claiming Food Expenses

There are two ways you can claim your food expenses.

(1) Use the standard meal allowance method.

(2) Use the actual food cost method.

Standard Meal Allowance Method

If you use the standard meal allowance method, you don't need to save any food receipts! At the end of the year, add up all the meals and snacks you served (including those reimbursed by the Food Program) and multiply by the annual standard meal allowance rate.

- All states except Hawaii and Alaska (2022 rate): $1.40 breakfast; $2.63 lunch/supper; $0.78 snack
- Hawaii: $1.63 breakfast; $3.08 lunch/supper; $0.91 snack
- Alaska: $2.23 breakfast; $4.26 lunch/supper; $1.27 snack

More on the Standard Meal Allowance Method

All providers are eligible to use the standard meal allowance method—even those not participating in the Food Program.

You can claim up to one breakfast, one lunch, one supper, and three snacks per day, per child. (Even though the Food Program will only reimburse you for three servings per day, you can deduct up to six servings as a business expense.) Do not count any meals served to your own children.

The meals and snacks you serve do not have to be nutritious to be deductible, although I urge all providers to serve nutritious food.

Exercise #5 Food Expenses

Which of the following meals/snacks are deductible?

	Deductible	Not Deductible
Candy bar served as an afternoon snack		
Fourth snack in one day served to one child		
Breakfast, if you are not on the Food Program		
Breakfast, if you are on the Food Program		
Lunch served to your own child		

Exercise #5 Answers

Candy bar served as an afternoon snack – Deductible

Fourth snack in one day served to one child – Not deductible

Breakfast, if you are not on the Food Program – Deductible

Breakfast, if you are on the Food Program – Deductible

Lunch served to your own child – Not deductible

Keep Proper Food Records

- Keep a daily record of all the meals and snacks that you serve.
- Save your Food Program monthly claim forms. For non-reimbursed meals, make a daily notation on a calendar, software program, or other record.
- One snack per day for one child for 1 year is equal to a deduction of \$202. For Hawaii, it’s \$237. For Alaska, it’s \$330. Every snack counts!

Actual Food Cost Method

The second way you can claim your food expenses is by using the actual food cost method. If you use this method, you must save your receipts for all your business food as well as all your personal food. This can be a difficult task for many providers because of the work involved in saving food receipts when your family eats out, for example, or when your spouse buys lunch away from home.

There are many ways to estimate your actual food costs using this method. You could buy your business food separately from your personal food. You could calculate your own average cost per meal per child. You could calculate what percentage of your entire food expense was spent on food for the children in your care.

In the end, most providers use the standard meal allowance rule because it is simpler to follow.

Section 6 Quiz

(1) It’s not a good idea to join the Food Program because you will lose the ability to deduct your food expenses.

True ___ False ___

(2) You can deduct the mileage to your dentist if you bring children in your care with you.

True ___ False ___

(3) You can deduct a maximum of three servings per day when using the standard meal allowance method.

True ___ False ___

Section 6 Quiz Answers

(1) False

(2) False

(3) False

Section 7
Other Tax Issues

Estimated Taxes

The IRS doesn't want to wait until the end of the year to receive your taxes. You must pay at least 90% of the federal or state taxes you owe each quarter. If you don't, there is a penalty.

If you are married, you can meet this requirement by having your spouse withhold an additional amount of their salary to cover your taxes. Have them fill out IRS Form W-4. Alternatively, you can file federal estimated taxes using IRS Form 1040ES.

If you are single, or if your spouse is also self-employed, then you must pay estimated taxes each quarter. The deadlines for federal estimated taxes are April 15, June 15, September 15, and January 15.

How much will you owe in taxes? A rough estimate is about 20% of your income from parents and the Food Program.

Getting Tax Help

- You can choose to do your own taxes, or you can seek help.
- You can use online tax software:
  - TurboTax – www.turbotax.com
  - H&R Block – www.hrblock.com
  - TaxAct – www.taxact.com
- You can hire a tax professional.

Will Your Taxes Be Done Accurately?

- Unfortunately, if you use tax software or hire a tax professional, you can't be sure that your taxes will be done accurately.
- There are many unique tax rules applicable to family child care providers that tax professionals may not understand (unfortunately!).
- Therefore, you need to understand these unique tax rules, so you can properly complete your own taxes, use tax software, or work with a tax professional.

Unique Tax Rules for Family Child Care

- “Ordinary and necessary” – In family child care, this means you can deduct the business portion of almost all your house expenses.
- Food Program – This is taxable income. You can deduct up to six servings per day per child, and the meals and snacks do not have to be nutritious.
- Time-space percentage – You can count all the hours that you use your home for business, including hours when children are not present. You can count rooms as regular use or exclusive use.
- Large expenses – You can deduct in 1 year the business portion of any expense except for a home, home improvement, or home addition.

Questions to Ask a Tax Professional

Here are questions that your tax professional should answer correctly:

- Should I depreciate my home? Always!
- Can I count hours spent on business activities after children are gone? Yes
- Can I deduct common household items such as cleaning supplies? Yes
- Can I have an exclusive use room and regular use room? Yes
- Can I deduct meals not reimbursed by the Food Program? Yes

How to Find a Tax Professional

- Ask other providers who use a tax professional if he or she is doing a good job.
- Look for an enrolled agent (EA) who is more likely to understand family child care (https://tnsea.org/).
- See my article: http://tomcopelandblog.com/how-to-find-choose-and-work-with-a-tax-professional-2

Worried About an IRS Audit?

- Don’t be. Your chances of being audited are less than 1%.
- Most audits are done at random. About the only way to reduce your chances of being audited is to show a business profit at least 3 out of every 5 years.
- Claim all expenses that you are entitled to and have the records to back it up. Don’t worry about a “red flag.”
- I’ve posted many articles about how to handle an audit on my website: www.tomcopelandblog.com

The 3-Year Rules

The IRS can audit you back 3 years. They can only audit back further if you committed fraud, didn't file a tax return, or significantly under-reported your income.

To protect yourself against an IRS audit, keep all business records for at least 3 years after filing your taxes. If you hire employees, keep your payroll records for at least 4 years.

If you discover that you made a mistake on your tax return, you can amend it back 3 years to correct your errors or claim a refund.

Save copies of your tax return for as long as you live.

Summary and Posttest

Summary

Here's a summary of the three most important things you can do to reduce your taxes:

- Save receipts for all your house expenses.
- Keep daily records of all the meals and snacks you serve to the children in your care. Pay particular attention to tracking meals and snacks not reimbursed by the Food Program.
- Track all the hours you work in your home. Keep a particular focus on tracking at least 2 months of hours spent on business activities in your home when the children in your care are not present.

Make it your goal to accomplish these three tasks throughout the year. You can do it!

Good luck!

Posttest

- It’s time to take the Recordkeeping Pretest/Posttest again!
- Answer the questions once more.
- By this time, you should have learned a lot and will get more answers correct.
- Don’t worry if some of your answers are wrong the second time around.
- It can take time to absorb everything this class has covered.
- If you pace yourself and learn a little more about recordkeeping each year, you will do fine.

Recordkeeping: Posttest

(1) For every $10 of business expenses you deduct on your tax return, you will save about $3–$4 in taxes.

a. True

b. False

c. I don’t know

(2) You must save your business records for at least 7 years after filing your taxes.

a. True

b. False

c. I don’t know

Recordkeeping: Posttest

(3) You can deduct a portion of the cost of a washer and dryer used in your business.

a. True

b. False

c. I don’t know

(4) You will lose money if you join the Food Program because you won’t be able to deduct all your food expenses.

a. True

b. False

c. I don’t know

Recordkeeping: Posttest

(5) You should not depreciate your home if you are planning to sell it soon.

a. True

b. False

c. I don't know

(6) You must depreciate a fence over 39 years.

a. True

b. False

c. I don't know

Recordkeeping: Posttest

(7) You can count time you spend on recordkeeping after children are gone in your time-space percentage calculation.

a. True

b. False

c. I don’t know

(8) If you went into business 10 years ago and did not depreciate your appliances, it’s too late to deduct them on your taxes.

a. True

b. False

c. I don’t know

Recordkeeping: Posttest

(9) You can always deduct the business portion of your car loan interest when claiming car expenses.

a. True

b. False

c. I don’t know

(10) You must report as income any parent fees, such as registration fees and late pick-up fees.

a. True

b. False

c. I don’t know

Recordkeeping: Pretest/Posttest Answers

(1) True
(2) False
(3) True
(4) False
(5) False
(6) False
(7) True
(8) False
(9) True
(10) True

Good Luck!

- Thanks for taking the time to finish this class!
- I appreciate all the hard work you do caring for children.
- Although recordkeeping is probably not your favorite thing to do, I hope you now realize its importance.
- As you spend a little more time each year keeping accurate records, it will become easier to do.
- Remember, keeping good records means saving more money on your taxes!

Resources

- Redleaf Calendar-Keeper: An annual family child care recordkeeping system: https://www.redleafpress.org/Redleaf-Calendar-Keeper-2022-A-Record-Keeping-System-for-Family-Child-Care-Professionals-P2623.aspx?
- Family Child Care Record Keeping Guide: Lists more than 1,000 allowable business deductions: www.redleafpress.org/Family-Child-Care-Record-Keeping-Guide-9th-Edition-P1133.aspx
- The Business of Family Child Care Record Keeping DVD, featuring Tom Copeland: www.redleafpress.org/Record-Keeping-The-Business-of-Family-Child-Care-DVD-P2509.aspx
- www.tomcopelandblog.com contains hundreds of articles about family child care record-keeping and taxes.
- www.kidkare.com is a comprehensive online record-keeping system.

Final Quiz

(1) Which snacks can you deduct if they are not reimbursed by the Food Program?

a. Potato chips and Kool-Aid
b. Candy bars
c. Crackers
d. All of the above

(2) Which of the following expenses can you deduct if you use the standard mileage rate method to claim car expenses?

a. Car loan interest
b. Car insurance
c. Parking
d. A and C only
e. All of the above

(3) How much of the cost of a DVD player can you deduct if it is used by your child care children as well as your family?

a. None of the cost
b. 100% of the cost
c. Part of the cost

Final Quiz

(4) If you owned a freezer before your business began, how much can you deduct?

a. None of it

b. The business portion

c. All of it

(5) How much of your water bill can you deduct as a business expense?

a. None of it

b. The business portion

c. All of it

(6) When are you likely to owe quarterly federal estimated taxes?

a. If you are single

b. If you are married and your spouse is self-employed

c. A and B

Final Quiz

(7) When can you deduct a new carpet?

a. 1 year

b. 15 years

c. 39 years

(8) Which one of the following statements is correct?

a. A provider should not join the Food Program if she spends more on food than she would get from the Food Program.

b. A provider should not join the Food Program because serving nutritious food is more expensive.

c. A provider should join the Food Program because she will have more money, after taxes, than if she did not join the Food Program.

d. A provider should join the Food Program because she will be able to deduct the cost of the food served to her own children.

Final Quiz

(9) How many hours can you count in your time-space percentage calculation spent on business activities when children are not present?

a. No more than 1 hour per day

b. No more than 2 hours per day

c. No more than 3 hours per day

d. No limit

(10) Which of the following statements is true?

a. You should always depreciate your home.

b. You should not depreciate your home if you are planning on selling it in the next 5 years.

c. You should not depreciate your home because you will owe more taxes when you sell it.

Final Quiz

(11) What impact will an exclusive-use room in your home have on your time-space percentage?

a. It will lower it

b. It will raise it

c. It won't make any difference

(12) If you forget to include a business deduction on your current year tax return, what can you do?

a. Nothing, it's too late

b. Amend your tax return

c. Claim the deduction on next year's tax return

(13) How many meals and snacks can you deduct for one child in a day, using the standard meal allowance method?

a. Three

b. Four

c. Six

d. As many as you serve

Final Quiz

(14) Which of the following expenses is not deductible?

a. Garden hose
b. Light bulbs
c. Motorcycle
d. Kitchen curtains

(15) You can deduct an expense in your business if it is "ordinary and necessary." What does this mean?

a. Typical
b. Common
c. Appropriate
d. Useful
e. All of the above

Final Quiz Answers

(1) D
(2) D
(3) C
(4) B
(5) B
(6) C
(7) A
(8) C
(9) D
(10) A

Final Quiz Answers

(11) B

(12) C

(13) C

(14) C

(15) E

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